

CHAPTER 3

THE MATCHING CONCEPT AND THE ADJUSTING PROCESS

CLASS DISCUSSION QUESTIONS

1.
 - a. Under cash-basis accounting, revenues are reported in the period in which cash is received and expenses are reported in the period in which cash is paid.
 - b. Under accrual-basis accounting, revenues are reported in the period in which they are earned and expenses are reported in the same period as the revenues to which they relate.
2.
 - a. 2006
 - b. 2005
3.
 - a. 2006
 - b. 2005
4. The matching concept is related to the accrual basis.
5. Yes. The cash amount listed on the trial balance is normally the amount of cash on hand and needs no adjustment at the end of the period.
6. No. The amount listed on the trial balance, before adjustments, normally represents the cost of supplies on hand at the beginning of the period plus the cost of the supplies purchased during the period. Some of the supplies have been used; therefore, an adjustment is necessary for the supplies used before the amount for the balance sheet is determined.
7. Adjusting entries are necessary at the end of an accounting period to bring the ledger up to date.
8. Adjusting entries bring the ledger up to date as a normal part of the accounting cycle. Correcting entries correct errors in the ledger.
9. Five different categories of adjusting entries include deferred expenses (prepaid expenses), deferred revenues (unearned revenues), accrued expenses (accrued liabilities), accrued revenues (accrued assets), and fixed assets (depreciation).
10. Statement (b): Increases the balance of an expense account.
11. Statement (a): Increases the balance of a revenue account.
12. Yes, because every adjusting entry affects expenses or revenues.
13.
 - a. The balance is the sum of the beginning balance and the amount of the insurance premiums paid during the period.
 - b. The balance is the unexpired premiums at the end of the period.
14.
 - a. The rights acquired represent an asset.
 - b. The justification for debiting Rent Expense is that when the ledger is summarized in a trial balance at the end of the month and statements are prepared, the rent will have become an expense. Hence, no adjusting entry will be necessary.
15.
 - a. The portion of the cost of a fixed asset deducted from revenue of the period is debited to Depreciation Expense. It is the expired cost for the period. The reduction in the fixed asset account is recorded by a credit to Accumulated Depreciation rather than to the fixed asset account. The use of the contra asset account facilitates the presentation of original cost and accumulated depreciation on the balance sheet.
 - b. Depreciation Expense—debit balance; Accumulated Depreciation—credit balance.
 - c. No, it is not customary for the balances of the two accounts to be equal in amount.
 - d. Depreciation Expense appears in the income statement; Accumulated Depreciation appears on the balance sheet.

EXERCISES

Ex. 3–1

- | | |
|---|---|
| <ol style="list-style-type: none"> 1. (c) Accrued expense (accrued liability) 2. (a) Deferred expense (prepaid expense) 3. (b) Deferred revenue (unearned revenue) 4. (d) Accrued revenue (accrued asset) | <ol style="list-style-type: none"> 5. (c) Accrued expense (accrued liability) 6. (c) Accrued expense (accrued liability) 7. (d) Deferred expense (prepaid expense) 8. (b) Deferred revenue (unearned revenue) |
|---|---|

Ex. 3–2

| Account | Answer |
|--------------------------------|---------------------------------------|
| Dividends | Does not normally require adjustment. |
| Accounts Receivable | Normally requires adjustment (AR). |
| Accumulated Depreciation | Normally requires adjustment (DE). |
| Cash | Does not normally require adjustment. |
| Interest Payable..... | Normally requires adjustment (AE). |
| Interest Receivable..... | Normally requires adjustment (AR). |
| Land..... | Does not normally require adjustment. |
| Office Equipment | Does not normally require adjustment. |
| Prepaid Rent..... | Normally requires adjustment (DE). |
| Supplies Expense | Normally requires adjustment (DE). |
| Unearned Fees | Normally requires adjustment (DR). |
| Wages Expense..... | Normally requires adjustment (AE). |

Ex. 3–3

| | | |
|-----------------------|-----|-----|
| Supplies Expense..... | 801 | |
| Supplies | | 801 |

Ex. 3–4

\$1,067 (\$118 + \$949)

Ex. 3–5

- a. Insurance expense (or expenses) will be understated. Net income will be overstated.
- b. Prepaid insurance (or assets) will be overstated. Stockholders' equity (retained earnings) will be overstated.

Ex. 3–6

| | | |
|----------------------------|-------|-------|
| a. Insurance Expense | 1,215 | |
| Prepaid Insurance | | 1,215 |
| b. Insurance Expense | 1,215 | |
| Prepaid Insurance | | 1,215 |

Ex. 3–7

| | | |
|----------------------------|-------|-------|
| a. Insurance Expense | 3,720 | |
| Prepaid Insurance | | 3,720 |
| b. Insurance Expense | 3,720 | |
| Prepaid Insurance | | 3,720 |

Ex. 3–8

| | | |
|---------------------|-------|-------|
| Unearned Fees | 9,570 | |
| Fees Earned | | 9,570 |

Ex. 3–9

- a. Rent revenue (or revenues) will be understated. Net income will be understated.
- b. Stockholders' equity (retained earnings) at the end of the period will be understated. Unearned rent (or liabilities) will be overstated.

Ex. 3–10

| | | |
|-------------------------|--------|--------|
| a. Salary Expense | 9,360 | |
| Salaries Payable..... | | 9,360 |
| b. Salary Expense | 12,480 | |
| Salaries Payable..... | | 12,480 |

Ex. 3–11

\$59,850 (\$63,000 – \$3,150)

Ex. 3–12

- a. Salary expense (or expenses) will be understated. Net income will be overstated.
- b. Salaries payable (or liabilities) will be understated. Stockholders' equity (retained earnings) will be overstated.

Ex. 3–13

- a. Salary expense (or expenses) will be overstated. Net income will be understated.
- b. The balance sheet will be correct. This is because wages payable has been satisfied, and the net income errors have offset each other. Thus, stockholders' equity (retained earnings) is correct.

Ex. 3–14

| | | |
|--|-------|-------|
| a. Taxes Expense | 945 | |
| Prepaid Taxes..... | | 945 |
| ($\$1,260 \div 12$) $\times 9 = \$945$ | | |
| Taxes Expense | 8,750 | |
| Taxes Payable | | 8,750 |
| b. \$9,695 (\$945 + \$8,750) | | |

Ex. 3–15

\$195,816,000 (\$128,776,000 + \$67,040,000)

Ex. 3–16

a. \$503,000,000

b. 63% (\$503,000,000 ÷ \$798,000,000)

Ex. 3–17

| | <u>Error (a)</u> | | <u>Error (b)</u> | |
|--|------------------|--------------|------------------|--------------|
| | Over-stated | Under-stated | Over-stated | Under-stated |
| 1. Revenue for the year would be | \$ 0 | \$6,900 | \$ 0 | \$ 0 |
| 2. Expenses for the year would be | 0 | 0 | 0 | 3,740 |
| 3. Net income for the year would be | 0 | 6,900 | 3,740 | 0 |
| 4. Assets at December 31 would be | 0 | 0 | 0 | 0 |
| 5. Liabilities at December 31 would be | 6,900 | 0 | 0 | 3,740 |
| 6. Stockholders' equity at December 31 would be | 0 | 6,900 | 3,740 | 0 |

Ex. 3–18

\$175,840 (\$172,680 + \$6,900 – \$3,740)

Ex. 3–19

a. Accounts Receivable 11,500
Fees Earned..... 11,500

b. No. If the cash basis of accounting is used, revenues are recognized only when the cash is received. Therefore, earned but unbilled revenues would not be recognized in the accounts, and no adjusting entry would be necessary.

Ex. 3–20

| | | |
|------------------------------|-------|-------|
| a. Unearned Fees..... | 8,100 | |
| Fees Earned..... | | 8,100 |
| b. Accounts Receivable | 6,450 | |
| Fees Earned..... | | 6,450 |

Ex. 3–21

- a. Fees earned (or revenues) will be understated. Net income will be understated.
- b. Accounts (fees) receivable (or assets) will be understated. Stockholders' equity (retained earnings) will be understated.

Ex. 3–22

| | | |
|-------------------------------|-------|-------|
| Depreciation Expense | 5,200 | |
| Accumulated Depreciation..... | | 5,200 |

Ex. 3–23

- a. \$204,600 (\$318,500 – \$113,900)
- b. No. Depreciation is an allocation of the cost of the equipment to the periods benefiting from its use. It does not necessarily relate to value or loss of value.

Ex. 3–24

- a. \$2,268,000,000 (\$5,891,000,000 – \$3,623,000,000)
- b. No. Depreciation is an allocation method, not a valuation method. That is, depreciation allocates the cost of a fixed asset over its useful life. Depreciation does not attempt to measure market values, which may vary significantly from year to year.

Ex. 3–25

- | | | | |
|----|--------------------------------|-------|-------|
| a. | Depreciation Expense | 7,500 | |
| | Accumulated Depreciation | | 7,500 |
- b. (1) Depreciation expense would be understated. Net income would be overstated.
- (2) Accumulated depreciation would be understated, and total assets would be overstated. Stockholders' equity (retained earnings) would be overstated.

Ex. 3–26

- | | | | |
|----|--|---|---|
| 1. | Accounts Receivable | 4 | |
| | Fees Earned | | 4 |
| 2. | Supplies Expense | 3 | |
| | Supplies | | 3 |
| 3. | Insurance Expense | 8 | |
| | Prepaid Insurance | | 8 |
| 4. | Depreciation Expense | 5 | |
| | Accumulated Depreciation—Equipment | | 5 |
| 5. | Wages Expense | 1 | |
| | Wages Payable | | 1 |

Ex. 3–27

1. The accountant debited Accounts Receivable for \$2,000 but did not credit Laundry Revenue. This adjusting entry represents accrued laundry revenue.
2. The accountant credited Laundry Equipment for the depreciation expense of \$5,600, instead of crediting the accumulated depreciation account.
3. The accountant credited the prepaid insurance account for \$1,700 but only debited the insurance expense account for \$700.
4. The accountant did not debit Wages Expense for \$850.
5. The accountant debited rather than credited Laundry Supplies for \$1,100.

The corrected adjusted trial balance is shown below.

**Minaret Laundry
Adjusted Trial Balance
May 31, 2006**

| | | |
|--------------------------------|----------------|----------------|
| Cash | 2,500 | ..... |
| Accounts Receivable | 9,500 | ..... |
| Laundry Supplies | 650 | ..... |
| Prepaid Insurance | 1,125 | ..... |
| Laundry Equipment..... | 85,600 | ..... |
| Accumulated Depreciation ..... | ..... | 61,300 |
| Accounts Payable ..... | ..... | 4,950 |
| Wages Payable ..... | ..... | 850 |
| Capital Stock ..... | ..... | 18,000 |
| Retained Earnings..... | ..... | 14,450 |
| Dividends | 10,000 | ..... |
| Laundry Revenue ..... | ..... | 68,900 |
| Wages Expense..... | 25,350 | ..... |
| Rent Expense | 15,575 | ..... |
| Utilities Expense | 8,500 | ..... |
| Depreciation Expense..... | 5,600 | ..... |
| Laundry Supplies Expense | 1,100 | ..... |
| Insurance Expense..... | 1,700 | ..... |
| Miscellaneous Expense | 1,250 | ..... |
| | 168,450 | 168,450 |

Ex. 3–28

a. (1) \$620 million increase (\$3,664 million – \$3,044 million)

20.4% increase (\$620 million ÷ \$3,044 million)

(2) 2003: 6.3% (\$3,644 million ÷ \$58,247 million)

2002: 5.7% (\$3,044 million ÷ \$53,553 million)

b. The net earnings increased during 2003 by 20.4%, a favorable trend. The percent of net earnings to net sales also increased—from 5.7% to 6.3%, a favorable trend.

Ex. 3–29

a. Dell Computer Corporation

| | <u>Amount</u> | <u>Percent</u> |
|-------------------------|---------------------|----------------|
| Net sales | \$35,404,000 | 100.0 |
| Cost of goods sold | (29,055,000) | 82.1 |
| Operating expenses | <u>(3,505,000)</u> | <u>9.9</u> |
| Operating income (loss) | <u>\$ 2,844,000</u> | <u>8.0</u> |

b. Gateway Inc.

| | <u>Amount</u> | <u>Percent</u> |
|-------------------------|---------------------|----------------|
| Net sales | \$ 4,176,325 | 100.0 |
| Cost of goods sold | (3,605,120) | 86.4 |
| Operating expenses | <u>(1,077,447)</u> | <u>25.8</u> |
| Operating income (loss) | <u>\$ (511,242)</u> | <u>(12.2)</u> |

c. Dell is more profitable than Gateway. Specifically, Dell's cost of goods sold of 82.1% is significantly less (4.3%) than Gateway's cost of goods sold of 86.4%. In addition, Gateway's operating expenses are over one-fourth of sales, while Dell's operating expenses are 9.9% of sales. The result is that Dell generates an operating income of 8.0% of sales, while Gateway generates a loss of 12.2% of sales. Obviously, Gateway must improve its operations if it is to remain in business and remain competitive with Dell.

PROBLEMS

Prob. 3–1A

| | | | |
|-------|--------------------------------|-------|-------|
| 1. a. | Accounts Receivable | 7,100 | |
| | Fees Earned..... | | 7,100 |
| b. | Supplies Expense..... | 1,860 | |
| | Supplies | | 1,860 |
| c. | Wages Expense | 1,380 | |
| | Wages Payable | | 1,380 |
| d. | Unearned Rent | 1,650 | |
| | Rent Revenue | | 1,650 |
| e. | Depreciation Expense | 1,120 | |
| | Accumulated Depreciation | | 1,120 |

2. Adjusting entries are a planned part of the accounting process to update the accounts. Correcting entries are not planned but arise only when necessary to correct errors.

Prob. 3–2A

| | | |
|-------------------------------|-------|-------|
| a. Supplies Expense | 1,420 | |
| Supplies..... | | 1,420 |
| b. Depreciation Expense..... | 1,450 | |
| Accumulated Depreciation..... | | 1,450 |
| c. Rent Expense | 9,500 | |
| Prepaid Rent..... | | 9,500 |
| d. Wages Expense..... | 1,050 | |
| Wages Payable..... | | 1,050 |
| e. Unearned Fees | 3,600 | |
| Fees Earned | | 3,600 |
| f. Accounts Receivable | 7,100 | |
| Fees Earned | | 7,100 |

Prob. 3–3A

| | | |
|-------------------------------|-------|-------|
| a. Supplies Expense | 1,505 | |
| Supplies..... | | 1,505 |
| b. Accounts Receivable | 1,750 | |
| Fees Earned | | 1,750 |
| c. Depreciation Expense..... | 1,600 | |
| Accumulated Depreciation..... | | 1,600 |
| d. Wages Expense..... | 380 | |
| Wages Payable..... | | 380 |
| e. Unearned Fees | 700 | |
| Fees Earned | | 700 |

Prob. 3–4A

2006

| | | | |
|----------------|---|--------------|--------------|
| Mar. 31 | Supplies Expense | 2,705 | |
| | Supplies | | 2,705 |
| 31 | Insurance Expense | 1,600 | |
| | Prepaid Insurance | | 1,600 |
| 31 | Depreciation Expense—Buildings | 4,100 | |
| | Accumulated Depreciation—Buildings | | 4,100 |
| 31 | Depreciation Expense—Trucks | 8,500 | |
| | Accumulated Depreciation—Trucks..... | | 8,500 |
| 31 | Utilities Expense | 515 | |
| | Accounts Payable | | 515 |
| 31 | Salary Expense | 1,080 | |
| | Salaries Payable..... | | 1,080 |
| 31 | Unearned Service Fees | 1,650 | |
| | Service Fees Earned | | 1,650 |

Prob. 3–5A

1.

| | | | |
|-----------|---|--------------|--------------|
| a. | Depreciation Expense—Building | 3,600 | |
| | Accumulated Depreciation—Building | | 3,600 |
| b. | Depreciation Expense—Equipment | 2,400 | |
| | Accumulated Depreciation—Equipment | | 2,400 |
| c. | Salaries and Wages Expense | 2,170 | |
| | Salaries and Wages Payable | | 2,170 |
| d. | Insurance Expense | 2,500 | |
| | Prepaid Insurance | | 2,500 |
| e. | Accounts Receivable | 4,350 | |
| | Fees Earned | | 4,350 |
| f. | Supplies Expense | 1,075 | |
| | Supplies | | 1,075 |
| g. | Unearned Rent | 4,400 | |
| | Rent Revenue | | 4,400 |

Prob. 3–5A Concluded

2.

GRECO SERVICE CO.
Adjusted Trial Balance
December 31, 2006

| | | |
|--|----------------|----------------|
| Cash | 4,200 | ..... |
| Accounts Receivable | 24,950 | ..... |
| Prepaid Insurance | 3,500 | ..... |
| Supplies | 375 | ..... |
| Land..... | 100,000 | ..... |
| Building..... | 161,500 | ..... |
| Accumulated Depreciation—Building ..... | ..... | 79,300 |
| Equipment..... | 80,100 | ..... |
| Accumulated Depreciation—Equipment ..... | ..... | 37,700 |
| Accounts Payable ..... | ..... | 7,500 |
| Salaries & Wages Payable..... | ..... | 2,170 |
| Unearned Rent..... | ..... | 2,800 |
| Capital Stock ..... | ..... | 35,000 |
| Retained Earnings..... | ..... | 122,100 |
| Dividends | 5,000 | ..... |
| Fees Earned..... | ..... | 261,550 |
| Rent Revenue ..... | ..... | 4,400 |
| Salaries and Wages Expense..... | 103,970 | ..... |
| Utilities Expense | 28,200 | ..... |
| Advertising Expense..... | 15,000 | ..... |
| Repairs Expense | 12,100 | ..... |
| Depreciation Expense—Equipment..... | 2,400 | ..... |
| Insurance Expense..... | 2,500 | ..... |
| Depreciation Expense—Building..... | 3,600 | ..... |
| Supplies Expense | 1,075 | ..... |
| Miscellaneous Expense | 4,050 | ..... |
| | <u>552,520</u> | <u>552,520</u> |

Prob. 3–6A

| | | | |
|-------|-------------------------------|-------|-------|
| 1. a. | Accounts Receivable | 9,600 | |
| | Fees Earned | | 9,600 |
| b. | Depreciation Expense..... | 3,500 | |
| | Accumulated Depreciation..... | | 3,500 |
| c. | Wages Expense..... | 1,450 | |
| | Wages Payable..... | | 1,450 |
| d. | Supplies Expense | 1,100 | |
| | Supplies..... | | 1,100 |

2.

| | Net Income | Total Assets | Total Liabilities | Total Stockholders' Equity |
|-------------------|------------------|------------------|----------------------|----------------------------------|
| Reported amounts | \$124,350 | \$500,000 | \$125,000 | \$375,000 |
| Corrections: | | | | |
| Adjustment (a) | + 9,600 | + 9,600 | 0 | + 9,600 |
| Adjustment (b) | - 3,500 | - 3,500 | 0 | - 3,500 |
| Adjustment (c) | - 1,450 | 0 | + 1,450 | - 1,450 |
| Adjustment (d) | - 1,100 | - 1,100 | 0 | - 1,100 |
| Corrected amounts | <u>\$127,900</u> | <u>\$505,000</u> | <u>\$126,450</u> | <u>\$378,550</u> |

Prob. 3-1B

| | | | |
|-------|-------------------------------|--------|--------|
| 1. a. | Supplies Expense | 1,565 | |
| | Supplies..... | | 1,565 |
| b. | Unearned Rent..... | 1,340 | |
| | Rent Revenue | | 1,340 |
| c. | Wages Expense..... | 2,150 | |
| | Wages Payable..... | | 2,150 |
| d. | Accounts Receivable | 11,278 | |
| | Fees Earned | | 11,278 |
| e. | Depreciation Expense..... | 1,000 | |
| | Accumulated Depreciation..... | | 1,000 |

2. Adjusting entries are a planned part of the accounting process to update the accounts. Correcting entries are not planned but arise only when necessary to correct errors.

Prob. 3–2B

| | | |
|-------------------------------|-------|-------|
| a. Accounts Receivable | 1,150 | |
| Fees Earned | | 1,150 |
| b. Supplies Expense | 1,390 | |
| Supplies..... | | 1,390 |
| c. Rent Expense | 6,000 | |
| Prepaid Rent..... | | 6,000 |
| d. Depreciation Expense..... | 1,650 | |
| Accumulated Depreciation..... | | 1,650 |
| e. Unearned Fees | 4,725 | |
| Fees Earned | | 4,725 |
| f. Wages Expense..... | 2,180 | |
| Wages Payable..... | | 2,180 |

Prob. 3–3B

| | | | |
|----|--------------------------------|-------|-------|
| a. | Accounts Receivable | 3,200 | |
| | Fees Earned | | 3,200 |
| b. | Supplies Expense | 2,590 | |
| | Supplies | | 2,590 |
| c. | Depreciation Expense | 3,850 | |
| | Accumulated Depreciation | | 3,850 |
| d. | Unearned Fees | 1,000 | |
| | Fees Earned | | 1,000 |
| e. | Wages Expense | 820 | |
| | Wages Payable | | 820 |

Prob. 3–4B

2006

| | | | |
|----------------|--|--------------|--------------|
| June 30 | Supplies Expense | 2,670 | |
| | Supplies | | 2,670 |
| 30 | Insurance Expense | 2,550 | |
| | Prepaid Insurance | | 2,550 |
| 30 | Depreciation Expense—Equipment | 7,020 | |
| | Accumulated Depreciation—Equipment | | 7,020 |
| 30 | Depreciation Expense—Automobiles | 3,650 | |
| | Accumulated Depreciation—Automobiles. | | 3,650 |
| 30 | Utilities Expense | 420 | |
| | Accounts Payable | | 420 |
| 30 | Salary Expense | 1,560 | |
| | Salaries Payable..... | | 1,560 |
| 30 | Unearned Service Fees | 2,000 | |
| | Service Fees Earned | | 2,000 |

Prob. 3–5B

1.

| | | | |
|-----------|--|--------------|--------------|
| a. | Insurance Expense | 3,200 | |
| | Prepaid Insurance | | 3,200 |
| b. | Supplies Expense..... | 1,040 | |
| | Supplies | | 1,040 |
| c. | Depreciation Expense—Building | 1,320 | |
| | Accumulated Depreciation—Building | | 1,320 |
| d. | Depreciation Expense—Equipment | 4,100 | |
| | Accumulated Depreciation—Equipment..... | | 4,100 |
| e. | Unearned Rent | 3,000 | |
| | Rent Revenue | | 3,000 |
| f. | Salaries and Wages Expense | 1,760 | |
| | Salaries and Wages Payable | | 1,760 |
| g. | Accounts Receivable | 3,200 | |
| | Fees Earned..... | | 3,200 |

Prob. 3–5B Concluded

2.

BERSERK COMPANY
Adjusted Trial Balance
December 31, 2006

| | | |
|--|----------------|----------------|
| Cash | 3,700 | ..... |
| Accounts Receivable | 22,100 | ..... |
| Prepaid Insurance | 1,600 | ..... |
| Supplies | 280 | ..... |
| Land..... | 75,000 | ..... |
| Building..... | 141,500 | ..... |
| Accumulated Depreciation—Building ..... | ..... | 93,020 |
| Equipment..... | 90,200 | ..... |
| Accumulated Depreciation—Equipment ..... | ..... | 69,400 |
| Accounts Payable ..... | ..... | 8,100 |
| Salaries & Wages Payable..... | ..... | 1,760 |
| Unearned Rent..... | ..... | 1,500 |
| Capital Stock ..... | ..... | 60,000 |
| Retained Earnings..... | ..... | 74,000 |
| Dividends | 10,000 | ..... |
| Fees Earned..... | ..... | 199,600 |
| Rent Revenue ..... | ..... | 3,000 |
| Salaries & Wages Expense..... | 97,340 | ..... |
| Utilities Expense | 28,250 | ..... |
| Advertising Expense..... | 15,200 | ..... |
| Repairs Expense | 11,500 | ..... |
| Depreciation Expense—Equipment..... | 4,100 | ..... |
| Insurance Expense..... | 3,200 | ..... |
| Depreciation Expense—Building..... | 1,320 | ..... |
| Supplies Expense | 1,040 | ..... |
| Miscellaneous Expense | 4,050 | ..... |
| | <u>510,380</u> | <u>510,380</u> |

Prob. 3–6B

| | | |
|-------------------------------|-------|-------|
| 1. a. Supplies Expense | 1,025 | |
| Supplies..... | | 1,025 |
| b. Accounts Receivable | 7,650 | |
| Fees Earned | | 7,650 |
| c. Depreciation Expense..... | 3,100 | |
| Accumulated Depreciation..... | | 3,100 |
| d. Wages Expense..... | 1,100 | |
| Wages Payable..... | | 1,100 |

2.

| | Net Income | Total Assets | Total Liabilities | Total Stockholders' Equity |
|-------------------|------------------|------------------|----------------------|----------------------------------|
| Reported amounts | \$207,320 | \$440,960 | \$29,720 | \$411,240 |
| Corrections: | | | | |
| Adjustment (a) | - 1,025 | - 1,025 | 0 | - 1,025 |
| Adjustment (b) | + 7,650 | + 7,650 | 0 | + 7,650 |
| Adjustment (c) | - 3,100 | - 3,100 | 0 | - 3,100 |
| Adjustment (d) | - 1,100 | 0 | + 1,100 | - 1,100 |
| Corrected amounts | <u>\$209,745</u> | <u>\$444,485</u> | <u>\$30,820</u> | <u>\$413,665</u> |

CONTINUING PROBLEM

1.

JOURNAL

Page 3

| Date | Description | Post. Ref. | Debit | Credit |
|-------------|---------------------------------|---------------|--------------------|--------|
| 2006 | | | | |
| May | 31 Accounts Receivable | 12 | 1,200 ¹ | |
| | Fees Earned | 41 | | 1,200 |
| | 31 Supplies Expense | 56 | 750 | |
| | Supplies..... | 14 | | 750 |
| | 31 Insurance Expense..... | 57 | 140 ² | |
| | Prepaid Insurance..... | 15 | | 140 |
| | 31 Depreciation Expense..... | 58 | 100 | |
| | Accum. Depr.—Office Equip. | 18 | | 100 |
| | 31 Unearned Revenue..... | 23 | 2,400 | |
| | Fees Earned | 41 | | 2,400 |
| | 31 Wages Expense..... | 50 | 130 | |
| | Wages Payable..... | 22 | | 130 |

¹ 30 hours × \$40 = \$1,200

² \$3,360 ÷ 24 months = \$140 per month

Continuing Problem Continued

2.

Cash

11

| Date | Item | Post. Ref. | Dr. | Cr. | Balance | |
|-------------|---------------|---------------|-------|-------|---------|-------|
| | | | | | Dr. | Cr. |
| 2006 | | | | | | |
| May 1 | Balance ..... | ✓ | ..... | ..... | 6,160 | ..... |
| 1 | | 1 | 3,000 | ..... | 9,160 | ..... |
| 1 | | 1 | ..... | 1,600 | 7,560 | ..... |
| 1 | | 1 | ..... | 3,360 | 4,200 | ..... |
| 2 | | 1 | 1,200 | ..... | 5,400 | ..... |
| 3 | | 1 | 4,800 | ..... | 10,200 | ..... |
| 3 | | 1 | ..... | 250 | 9,950 | ..... |
| 4 | | 1 | ..... | 150 | 9,800 | ..... |
| 8 | | 1 | ..... | 200 | 9,600 | ..... |
| 11 | | 1 | 600 | ..... | 10,200 | ..... |
| 13 | | 1 | ..... | 500 | 9,700 | ..... |
| 14 | | 1 | ..... | 1,200 | 8,500 | ..... |
| 16 | | 2 | 1,100 | ..... | 9,600 | ..... |
| 21 | | 2 | ..... | 240 | 9,360 | ..... |
| 22 | | 2 | ..... | 500 | 8,860 | ..... |
| 23 | | 2 | 400 | ..... | 9,260 | ..... |
| 27 | | 2 | ..... | 560 | 8,700 | ..... |
| 28 | | 2 | ..... | 1,200 | 7,500 | ..... |
| 29 | | 2 | ..... | 170 | 7,330 | ..... |
| 30 | | 2 | 600 | ..... | 7,930 | ..... |
| 31 | | 2 | 2,000 | ..... | 9,930 | ..... |
| 31 | | 2 | ..... | 600 | 9,330 | ..... |
| 31 | | 2 | ..... | 2,000 | 7,330 | ..... |

Accounts Receivable

12

2006

| | | | | | | |
|-------|----------------|---|-------|-------|-------|-------|
| May 1 | Balance ..... | ✓ | ..... | ..... | 1,200 | ..... |
| 2 | ..... | 1 | ..... | 1,200 | — | — |
| 23 | ..... | 2 | 1,160 | ..... | 1,160 | ..... |
| 30 | ..... | 2 | 600 | ..... | 1,760 | ..... |
| 31 | Adjusting..... | 3 | 1,200 | ..... | 2,960 | ..... |

Continuing Problem Continued

| | | | | | | 14 | |
|--|----------------|---------------|-------|-------|---------|-----------|--|
| Supplies | | | | | | | |
| Date | Item | Post. Ref. | Dr. | Cr. | Balance | | |
| | | | | | Dr. | Cr. | |
| 2006 | | | | | | | |
| May 1 | Balance ..... | ✓ | ..... | ..... | 170 | ..... |  |
| 18 | ..... | 2 | 750 | ..... | 920 | ..... |  |
| 31 | Adjusting..... | 3 | ..... | 750 | 170 | ..... |  |
| Prepaid Insurance | | | | | | 15 | |
| 2006 | | | | | | | |
| May 1 | ..... | 1 | 3,360 | ..... | 3,360 | ..... |  |
| 31 | Adjusting..... | 3 | ..... | 140 | 3,220 | ..... |  |
| Office Equipment | | | | | | 17 | |
| 2006 | | | | | | | |
| May 5 | ..... | 1 | 5,000 | ..... | 5,000 | ..... |  |
| Accumulated Depreciation—Office Equipment | | | | | | 18 | |
| 2006 | | | | | | | |
| May 31 | Adjusting..... | 3 | ..... | 100 | ..... | 100 | |
| Accounts Payable | | | | | | 21 | |
| 2006 | | | | | | | |
| May 1 | Balance ..... | ✓ | ..... | ..... | ..... | 250 | |
| 3 | ..... | 1 | 250 | ..... | — | — |  |
| 5 | ..... | 1 | ..... | 5,000 | ..... | 5,000 | |
| 18 | ..... | 2 | ..... | 750 | ..... | 5,750 | |
| Wages Payable | | | | | | 22 | |
| 2006 | | | | | | | |
| May 31 | Adjusting..... | 3 | ..... | 130 | ..... | 130 | |
| Unearned Revenue | | | | | | 23 | |
| 2006 | | | | | | | |
| May 3 | ..... | 1 | ..... | 4,800 | ..... | 4,800 | |
| 31 | Adjusting..... | 3 | 2,400 | ..... | ..... | 2,400 | |

Continuing Problem Continued

Capital Stock 31

| Date | Item | Post. Ref. | Dr. | Cr. | Balance | |
|-------------|---------------|---------------|-------|-------|---------|--------|
| | | | | | Dr. | Cr. |
| 2006 | | | | | | |
| May 1 | Balance ..... | ✓ | ..... | ..... | ..... | 7,000 |
| 1 | ..... | 1 | ..... | 3,000 | ..... | 10,000 |

Retained Earnings 32

This account is not used in Chapter 3.

Dividends 33

| | | | | | | |
|-------------|---------------|---|-------|-------|-------|-------|
| 2006 | | | | | | |
| May 1 | Balance ..... | ✓ | ..... | ..... | 250 | ..... |
| 31 | ..... | 2 | 2,000 | ..... | 2,250 | ..... |

Income Summary 34

This account is not used in Chapter 3.

Fees Earned 41

| | | | | | | |
|-------------|----------------|---|-------|-------|-------|--------|
| 2006 | | | | | | |
| May 1 | Balance ..... | ✓ | ..... | ..... | ..... | 4,750 |
| 11 | ..... | 1 | ..... | 600 | ..... | 5,350 |
| 16 | ..... | 2 | ..... | 1,100 | ..... | 6,450 |
| 23 | ..... | 2 | ..... | 1,560 | ..... | 8,010 |
| 30 | ..... | 2 | ..... | 1,200 | ..... | 9,210 |
| 31 | ..... | 2 | ..... | 2,000 | ..... | 11,210 |
| 31 | Adjusting..... | 3 | ..... | 1,200 | ..... | 12,410 |
| 31 | Adjusting..... | 3 | ..... | 2,400 | ..... | 14,810 |

Wages Expense 50

| | | | | | | |
|-------------|----------------|---|-------|-------|-------|-------|
| 2006 | | | | | | |
| May 1 | Balance ..... | ✓ | ..... | ..... | 400 | ..... |
| 14 | ..... | 1 | 1,200 | ..... | 1,600 | ..... |
| 28 | ..... | 2 | 1,200 | ..... | 2,800 | ..... |
| 31 | Adjusting..... | 3 | 130 | ..... | 2,930 | ..... |

Continuing Problem Continued

Office Rent Expense 51

| Date | Item | Post. Ref. | Dr. | Cr. | Balance | |
|-------------|---------------|---------------|-------|-------|---------|-------|
| | | | | | Dr. | Cr. |
| 2006 | | | | | | |
| May 1 | Balance ..... | ✓ | ..... | ..... | 1,000 | ..... |
| 1 | ..... | 1 | 1,600 | ..... | 2,600 | ..... |

Equipment Rent Expense 52

| | | | | | | |
|-------------|---------------|---|-------|-------|-------|-------|
| 2006 | | | | | | |
| May 1 | Balance ..... | ✓ | ..... | ..... | 650 | ..... |
| 13 | ..... | 1 | 500 | ..... | 1,150 | ..... |

Utilities Expense 53

| | | | | | | |
|-------------|---------------|---|-------|-------|-----|-------|
| 2006 | | | | | | |
| May 1 | Balance ..... | ✓ | ..... | ..... | 300 | ..... |
| 27 | ..... | 2 | 560 | ..... | 860 | ..... |

Music Expense 54

| | | | | | | |
|-------------|---------------|---|-------|-------|-------|-------|
| 2006 | | | | | | |
| May 1 | Balance ..... | ✓ | ..... | ..... | 940 | ..... |
| 21 | ..... | 2 | 240 | ..... | 1,180 | ..... |
| 31 | ..... | 2 | 600 | ..... | 1,780 | ..... |

Advertising Expense 55

| | | | | | | |
|-------------|---------------|---|-------|-------|-------|-------|
| 2006 | | | | | | |
| May 1 | Balance ..... | ✓ | ..... | ..... | 600 | ..... |
| 8 | ..... | 1 | 200 | ..... | 800 | ..... |
| 22 | ..... | 2 | 500 | ..... | 1,300 | ..... |

Supplies Expense 56

| | | | | | | |
|-------------|----------------|---|-------|-------|-----|-------|
| 2006 | | | | | | |
| May 1 | Balance ..... | ✓ | ..... | ..... | 180 | ..... |
| 31 | Adjusting..... | 3 | 750 | ..... | 930 | ..... |

Insurance Expense 57

| | | | | | | |
|-------------|----------------|---|-----|-------|-----|-------|
| 2006 | | | | | | |
| May 31 | Adjusting..... | 3 | 140 | ..... | 140 | ..... |

Continuing Problem Concluded

| | | | | | | | |
|-----------------------------|----------------|-------------------|------------|------------|------------|----------------|--|
| Depreciation Expense | | | | | | 58 | |
| | | | | | | <u>Balance</u> | |
| Date | Item | Post. Ref. | Dr. | Cr. | Dr. | Cr. | |
| 2006 | | | | | | | |
| May 31 | Adjusting..... | 3 | 100 | ..... | 100 | ..... |  |

| | | | | | | | |
|------------------------------|---------------|---|-------|-------|-----|-----------|--|
| Miscellaneous Expense | | | | | | 59 | |
| 2006 | | | | | | | |
| May 1 | Balance ..... | ✓ | ..... | ..... | 150 | ..... |  |
| 4 | ..... | 1 | 150 | ..... | 300 | ..... |  |
| 29 | ..... | 2 | 170 | ..... | 470 | ..... |  |

3.

**DANCIN MUSIC
Adjusted Trial Balance
May 31, 2006**

| | | |
|--|------------|--------------|
| Cash | 7,330 | ..... |
| Accounts Receivable | 2,960 | ..... |
| Supplies | 170 | ..... |
| Prepaid Insurance | 3,220 | ..... |
| Office Equipment | 5,000 | ..... |
| Accumulated Depreciation—Office Equipment..... | ..... | 100 |
| Accounts Payable ..... | ..... | 5,750 |
| Wages Payable ..... | ..... | 130 |
| Unearned Revenue ..... | ..... | 2,400 |
| Capital Stock ..... | ..... | 10,000 |
| Dividends | 2,250 | ..... |
| Fees Earned..... | ..... | 14,810 |
| Wages Expense..... | 2,930 | ..... |
| Office Rent Expense | 2,600 | ..... |
| Equipment Rent Expense | 1,150 | ..... |
| Utilities Expense | 860 | ..... |
| Music Expense | 1,780 | ..... |
| Advertising Expense..... | 1,300 | ..... |
| Supplies Expense | 930 | ..... |
| Insurance Expense..... | 140 | ..... |
| Depreciation Expense..... | 100 | ..... |
| Miscellaneous Expense | <u>470</u> | <u>.....</u> |

33,190

33,190

SPECIAL ACTIVITIES

Activity 3–1

It is acceptable for Ruth to prepare the financial statements for Macaw Real Estate on an accrual basis. The revision of the financial statements to include the accrual of the \$12,500 commissions as of December 31, 2005, is proper if there remain no contingencies related to the signed, unconditional contract of sale. That is, if the closing and title transfer is not contingent upon an appraisal, obtaining a loan, etc., then the earnings process has been completed from the perspective of Macaw Real Estate and the commissions have been earned. If contingencies remain, then the commission should not be accrued as of December 31, 2005. Indicating on the loan application to Second National Bank that Macaw Real Estate has not been rejected previously for credit is unethical and unprofessional. In addition, intentionally filing false loan documents is illegal.

Activity 3–2

The cost of the warranty repairs, \$725, should be recognized as an expense of 2006 in order to properly match revenues from the sale of the Expedition with the related expenses. Since the cost of the actual repairs will not be known at the time of sale (2006), Ford Motor Co. would estimate warranty costs and expenses at the end of 2006. This estimate would be recorded in the accounts through use of an adjusting entry. The adjusting entry would debit Warranty Expense and credit Estimated Warranty Payable, a liability account.

Activity 3–3

Revenue is normally recorded when the services are provided or when the goods are delivered (title passes) to the buyer. By waiting until after the services are provided, the expenses of providing the services can be more accurately measured and matched against the related revenues. Also, at this point, the provider of the services has a right to demand payment for the services if payment hasn't already been received.

Airlines, such as American Airlines, normally record revenue from ticket sales after completing a flight. At this point, the boarding passes, which have been collected from the passengers, represent revenue to the airline. In addition, the expenses related to each flight, such as landing fees and fuel, would have been incurred and would be accurately measured.

Note to Instructors: You might point out to students the following points related to the discussion of the adjusting process in this chapter.

- (1) The receipt of revenue from customers in advance of a flight represents unearned revenues to the airline. For example, the purchase of discount tickets, which often requires prepayment months in advance of the actual flight, is unearned revenue to the airline.
- (2) At the end of the airline's accounting period, it would have adjusting entries related to such items as the following:
 - Accrued wages for employees
 - Depreciation on airplanes, terminal buildings, etc.
 - Unearned revenues (described above)
 - Accrued income from transporting freight, etc.
 - Accrued income from other airlines
(When a flight is delayed or canceled, airlines often accept passengers from other airlines and then later collect the revenue from the other airline.)
 - Prepaid expenses related to insurance, etc.

Activity 3–4

- a. There are several indications that adjusting entries were not recorded before the financial statements were prepared, including:
 1. All expenses on the income statement are identified as “paid” items and not as “expenses.”
 2. No expense is reported on the income statement for depreciation, and no accumulated depreciation is reported on the balance sheet.
 3. No supplies, accounts payable, or wages payable are reported on the balance sheet.
- b. Likely accounts requiring adjustment include:
 1. Truck (for depreciation).
 2. Supplies (paid) expense for supplies on hand.
 3. Insurance (paid) expense for unexpired insurance.
 4. Wages accrued.
 5. Utilities accrued.

Activity 3–5

Note to Instructors: The purpose of this activity is to familiarize students with behaviors that are common in codes of conduct. In addition, this activity addresses an actual ethical dilemma for students.

Activity 3–6

- 1. The answers will vary among the student groups. The objective of this case is to generate student interest and discussion of business strategies.**

The advantages of the “do-it-yourself” strategy are as follows:

- a. This strategy requires less capital equipment and training of employees. For example, expensive automotive diagnostic equipment will not have to be purchased and Auto-Mart will not have to train its employees in auto repair and service. That is, it will be easier to staff the stores with sales personnel than with mechanics.**
- b. This strategy emphasizes low costs and has worked well for other companies in the industry, such as AutoZone, Pep Boys, and the automobile departments of Wal-Mart and Kmart.**

The advantages of the “do-it-for-me” strategy are as follows:

- a. Demographically, the population of the United States is aging and is becoming more affluent. In the future, such demographics mean that more customers will be less willing to fix their own cars. That is, they would rather pay someone to fix their cars for them.**
 - b. Increased complexity of cars makes it more difficult for customers to repair their own cars.**
 - c. The margins are typically higher for service and maintenance than for retail parts (i.e., service and maintenance are more profitable).**
 - d. Kmart recently shut down hundreds of repair and service centers, thus providing an opportunity to offer Kmart customers “do-it-for-me” service.**
- 2. Examples of “do-it-yourself” include AutoZone, Pep Boys, and Napa Auto Parts in the automotive industry. In the home improvement industry, examples include Home Depot and Lowe’s.**

Examples of “do-it-for-me” include automotive dealerships and repair and service centers located at Sears, Wal-Mart, and Kmart. Other automotive examples include Mr. Transmission, Midas Muffler, and Brake-0.

